Testimony of

California Farmers Union
President Joaquin Contente

Before the
U.S. House Agriculture Subcommittee
On
Department Operations, Oversight, Diary,
Nutrition and Forestry

Field Hearing to
Review the state of the California dairy industry

Saturday, September 16, 2006
Fresno, CA

Good morning, my name is Joaquin Contente. I own and operate an 850-cow dairy with my brother and family in Hanford, California. I am president of the California Farmers Union which represents more than 2500 farmers and ranchers statewide including the dairy producer members of the California Dairy Campaign (CDC). I currently serve on the board of directors of the National Farmers Union, which represents 250,000 family farm and ranch members across the United States. I greatly appreciate the opportunity to testify here today and commend the committee for its leadership in holding a hearing to consider the state of the California dairy industry.

I have been involved in the dairy industry here in California my entire life and I believe that producers today are facing the greatest challenges I have seen in my lifetime. Due to low producer prices, rising imports of concentrated dairy products, consolidation, a lack of competition and a range of other challenges, the future for many producers in this state is in jeopardy. We urge federal lawmakers to take immediate steps to improve our outlook by stabilizing producer prices, applying effective tariffs to dairy imports and taking immediate steps to make the dairy sector more competitive.

The California Milk Advisory Board (CMAB) recently completed a study titled "Foundation for a Consumer-Driven Dairy Growth Strategy" to determine how dairy producer and processors can grow the industry profitability during the next 20 years. The report states, "The strategy that worked so well over the last two decades is not likely to lead to profitable growth in the future. Farmers will probably face increased regulatory costs, lower mailbox prices and the need to provide capital to build processing plants. These factors could very well lead to a decline in overall industry profits." The report further concludes that "The advantages of the California pricing system that attracted proprietary processors in the past have eroded."

The report confirmed many of the concerns Farmers Union has held about the state of the dairy industry in California. We believe federal lawmakers should take steps to improve our outlook by stabilizing producer prices, addressing rising imports of concentrated dairy products and fostering greater competition in the dairy sector.

Improve Low Producer Prices

Prices paid to dairy producers throughout the state today are 30 percent below our cost of production and the outlook for the future is uncertain. Producer prices have reached their lowest levels in two years. A 1000 cow dairy with average costs is currently losing more than $60,000 per month or $720,000 per year.

It is difficult, if not impossible, for producers to pay their feed and other input costs when our price does not cover our cost of production. As a result, low dairy producer prices are having a ripple effect on the rest of the state agricultural economy.

At the same time that producer prices have dropped, our input costs continue to go up and up. Record high energy prices affect every stage of our dairy operations. High fuel prices increase the amount producers spend to grow or purchase feed for our cows. CDFA estimates indicate that producers are paying on average 16.4 cents per cwt in surcharges on their feed and transportation bills. Under the current system, producers are not able to recoup our higher energy costs from the market. It is the processors and retailers who have that ability, not the producers.

MAILBOX PRICES

YEAR	California	Upper Mid-West	Difference
1999	13.44	13.56	-0.12
2000	11.51	11.55	-0.04
2001	13.89	14.4	-0.51
2002	10.99	11.84	-0.85
2003	11.48	12.01	-0.53
2004	14.76	16.34	-1.58
2005	13.88	15.23	-1.35
May-06	**10.48**	**11.97**	**-1.49**

Reform the California Milk Pricing System

As you know, the 1996 farm bill provided California the opportunity to join the Federal Milk Marketing Order system, but the state chose not to join. As a result of California's refusal, the entire federal system was forced to adopt California pricing formulas, which include make-allowances with built in cost of production values for plants. In order for California to maintain market share, it reacted by adjusting its formulas to remain below the Federal Order producer prices.

According to a recent edition of the Cheese Reporter, "California's mailbox price last year was $1.47 per hundredweight below Wisconsin's. So even if it costs California 10 cents per pound to haul cheese to the Midwest, it still has a 47-cent per hundred advantage over Wisconsin."

The California pricing system is causing two things to happen. Due to the make allowance rate, price adjusters and other factors, California processors are able to sell dairy products at prices that are below prevailing market prices. California prices in turn lower the CME price upon which our producer price is based. Also due to the current formulas, California plants are continuously asking for more milk than the market is demanding.

We believe the current make allowance system overall sends a false signal to processors to continue production regardless of market demand. The current fixed make allowance system provides a strong incentive for processors to run as much raw milk as possible through a plant regardless of market conditions. The result from this system is that it puts the needs of the processor at odds with the needs of the dairy producer. Too much milk reduces the price to the dairy farmers and milk shortages decrease the amount of milk available to the processor.

We believe the make allowance system should be reformed so that it provides benefits to the producer and processor. We favor the establishment of a variable make allowance that would tie processor and producer prosperity together. A variable make allowance would increase significantly when milk prices are high, thereby giving an incentive to the processor to continue production because the return would be greater. However when milk prices are low the make allowance would decrease and send a signal to the processor to limit production in order to allow demand to catch up with production. We believe a variable make allowance is a "win-win" proposal because it would enable producers and processors to make a higher return when milk prices rise.

As long as the manufacturing allowance is fixed at the processor's cost plus a return on investment, and is paid for by farmers, the processing segment of the industry will be unconcerned with market signals. We need a system that works with the marketplace at all levels: producer, processor, wholesaler, retailer and consumer to provide an equitable, stable and viable economic environment for all segments of the dairy industry.

Recently CDFA decided to increase the manufacturing allowance, which would lower producer prices even further. The additional amount producers pay processors through the cost allowance will not benefit producers in this state because investment is going elsewhere. A recent article in Western Business Dairy stated that expansion is not likely to occur in California due to the fact that other states such as Indiana, Kansas, Ohio, Nebraska, Texas, and Wisconsin have an advantage due to their closer proximity to consumers in the Eastern portion of the U.S. As well these states are favorable for expansion due to lower feed and other cost inputs including labor. Seventy-seven percent of the U.S. population lives outside of the Western States and processors and well as producers are leaving California to service that larger market with less expense.

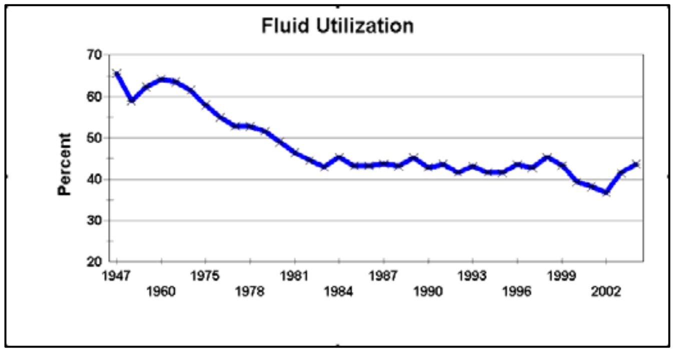
Improve agricultural trade policies

In 1995, the U.S. became a net-importer of dairy products for the first time as a result of the dramatic changes to federal dairy policy. The balance of trade for U.S. dairy products in 2004 totaled $1,452,904,000 in exports and $2,330,709,000 in imports. Today, due to politically motivated domestic dairy policies, the U.S. imports approximately 10 percent of its consumption needs. The imports consist primarily of proteins, cheese and butter. The U.S. exports a significant amount of lower valued lactose, as a result of being the world's largest cheese producer.

Milk Equivalent (Billion Lbs.)	Factor	2001	2002	2003	2004	2005
CHEESE	x10	4.45	4.75	4.75	4.71	4.60
CASEIN	x39	8.58	7.93	8.94	8.72	8.36
BUTTER	x4.2	0.32	0.14	0.13	0.22	0.16
MPC	x22	1.72	2.01	2.34	2.12	2.67
LACTOSE	x5.5	0.06	0.05	0.08	0.06	0.06
TOTAL		15.13	14.88	16.24	15.84	15.85
U.S. MILK PRODUCTION	(Billion)	165.336	169.758	170.394	170.934	176.989
PERCENT OF U.S. PRODUCTION		9.15%	8.77%	9.53%	9.27%	8.95%

UNITED STATES DEPARTMENT OF AGRICULTURE FAS AGRICULTURAL IMPORT COMMODITY AGGREGATIONS

When the U.S. became a net importer of dairy products it caused a new era of tremendous volatility in the dairy market. Previously, the U.S. had not experienced the degree of instability unless the supply came in close relationship to the demand. After the parity system was eliminated in the early 1980's, the U.S. still had ample production for all domestic consumption needs and world market demands. The lower support prices, coupled with ample supply caused producer prices to plummet. The next decade can be best described as the "Wild Roller Coaster of Producer Prices". Prices during some months would leap to $16 - $17 - $18 or even $20 per cwt, yet within a matter of weeks there would be a $6 per cwt drop! This volatility has shifted most of the risk to the producers, making it difficult to budget or plan.



Another factor in the "Wild Roller Coaster" is the amount of milk protein imports penetrating our borders without tariffs. This loophole, which allows caseins, caseinates and milk protein concentrate, duty free access was an oversight by U.S. negotiators at the Uruguay Round. Importers have also avoided tariffs on skim milk powder by blending casein with skim powder and calling it milk protein concentrate.

Foster Competition in the Dairy Sector

Unfortunately, consolidation within the agricultural industry has increased in recent years and has brought about the demise of thousands of family-run farms. Independent producers are finding it increasingly difficult to participate in a fair, open and competitive market. The consolidation trend has spread beyond the farm gate and now threatens independent retailers. Since 1999, National Farmers Union has commissioned a series of studies by the University of Missouri-Columbia Department of Rural Sociology to gauge concentration in agricultural and retail markets. The latest update, released in February 2005, reveals that the top four firms in most agricultural sectors have tightened their strong-hold since the 2002 study.

FOOD RETAILING **CR5 = 46%***

Supermarket	Grocery Sales*
1. Wal-Mart Sores	$66.465 Billion
2. Kroger Co.	46.315 Billion
3. Albertsons, Inc.	31.962 Billion
4. Safeway, Inc.	29.572 Billion
5. Ahold USA, Inc.	25.105 Billion

Source: * *Progressive Grocer's Super 50* (5/1/04)

Due to increased levels of concentration and consolidation, there is a lack of competition in the dairy sector in the U.S. A few major companies dominate the market, leaving producers and consumers to suffer as a result. In order for the dairy industry to be viable and sustainable in the future, policy decision-makers need to take immediate steps to foster and restore competition in the marketplace.

DAIRY PROCESSORS

	Annual Sales *
1. Dean Foods	$8,260 Million
2. Kraft Foods (Majority owner is Philip Morris)	$4,300 Million
3. Land O'Lakes	$2,969 Million
4. Schreiber Foods, Inc.	$2,200 Million

*Source: *Dairy Foods: Dairy 100 (2004)*

The United States is the worlds' largest market for dairy products today. However, we are second to India in total milk production. The approximate value of the nearly 170 billion pounds of U.S. milk produced for 2004 was $27 billion dollars at the farm level. The top producing states include California (21%), Wisconsin (13%), New York (7%), Pennsylvania (6%) and Idaho (5%). Cooperatives in the U.S. handle over 80% of the total milk production. However, not all cooperatives actually process their members' milk; some only market the milk collectively for their members.

During the past two decades, annual U.S. per capita sales of fluid milk has fallen steadily from year to year; 233.76 pounds (1980) to less than 185.9 pounds (2003). During this same time U.S.

per capita consumption of selected dairy products (fluid milk, cream, butter, frozen dairy and cheese) rose steadily; from 541 pounds (1980) to 594 pounds (2003). Annual U.S. per capita consumption of milk has declined from yearly since 1970. However, the consumption of cheese has virtually doubled over the last 20 years, from roughly 15 to 30 pounds.

Chicago Mercantile Exchange (CME) Reforms

The Chicago Mercantile Exchange (CME) sets the price dairy farmers receive for their milk, despite the fact that a very small percentage of dairy products are traded on the market. Dairy producers across the country are very concerned that the lack of federal oversight and transparency at the CME has led to market manipulation, which may be resulting in a highly volatile market, negatively impacting producers.

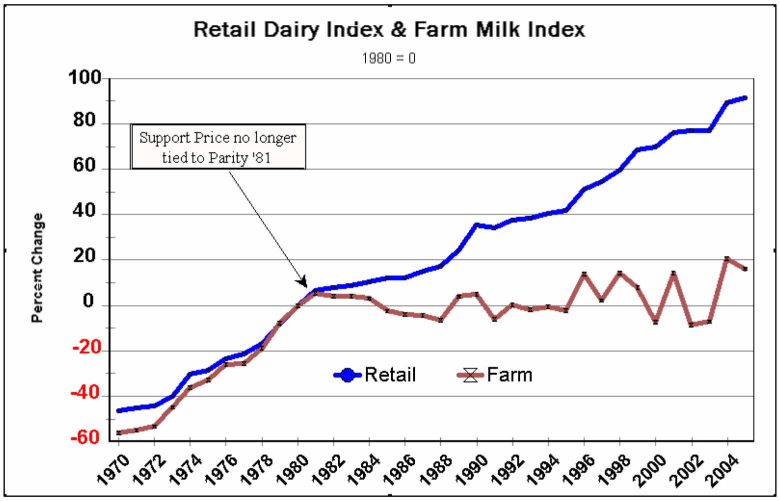
Historically, the CME trades an average of 20-25 loads of block cheese per week. However, USDA's Dairy Market News reports that for a period of 80 days this spring, only 26 loads of block cheese moved on the market -- despite an alleged surplus of cheese across the country. If a surplus of cheese does exist, why is the CME only trading 26 loads in 80 days? Due to the lack of transparency at the CME, producers that may be economically impacted by anti-competitive trading practices, have no recourse to independently inquire or investigate the lack of competition in the marketplace. If the CME was a more open and honest market, more businesses would trade and increase the volume to create a more accurate and reliable market that better reflects the actual milk production in the United States. We call upon federal lawmakers to take immediate action to investigate the alleged anti-competitive trading practices of the CME.

One of the greatest challenges facing U.S. producers and every other producer in the world is consolidation and concentration of the marketplace, which also drives market globalization. Capitalistic markets function properly when there is a balance of buyers and sellers. There are about 60,000 dairy farms marketing milk today through 200 cooperatives. Half a century ago, there were 180,000 dairy producers marketing through 1,000 cooperatives. While the number of farms and cooperatives continue to decline, the marketing presence of farmer-owned dairy cooperatives has actually expanded during the past generation. Despite this expansion there is less competition vying for producers at the co-op level, with more intervention by non-cooperatives and non-farmer controlled businesses.

Dairy cooperatives continue to grow in size and form strategic alliances with private entities. For example, my own cooperative, Land O' Lakes, sells a large portion of their cheese to Kraft Foods. The largest cooperative, Dairy Farmers of America, has ongoing agreements to supply milk to Dean Foods and Leprino Foods, and continues to expand its relationship with Fonterra. Cooperatives justify their actions by claiming they are subject to the growing demands of retailers. Wal-Mart, for example, wishes to consider no more than two suppliers for each food product it features in its stores across the U.S. The consolidation and concentration not only harm producers through lower prices, but also negatively impacts consumers with less choice at the grocery store.

In most U.S. metropolitan areas, one company, Dean Foods, has acquired the majority of fluid plants. Two corporations dominate the cheese sector; Kraft Foods at the retail level and Leprino

Foods at the food service level. Regardless of which cooperative a U.S. producer markets his milk, at the end of the day the vast majority of milk is purchased by only three major buyers that dictate each market. Dean Foods dominates the fluid market, Kraft owns the retail market and Leprino runs the food service market. Until steps can be taken to end the stranglehold that these three entities have on the three major components of the dairy sector, competition will be stifled and producer prices depressed.



Economic power concentrated in the hands of a few players has essentially eliminated the price system, which capitalism is thought to rest. The farm-gate price is no longer cost plus profit; instead it is a command economy with a few corporate players dictating farm price. The loss of producer economic power is best illustrated by the widening gap between retail prices and farm-gate prices. While consumers continue to experience sticker-shock on dairy products, dairy producers are left with a shrinking percentage of the consumer dollar.

Solutions

To improve producer prices we call upon Congress to pass legislation to establish a $12.50 dairy support purchase price that is funded through a producer assessment.

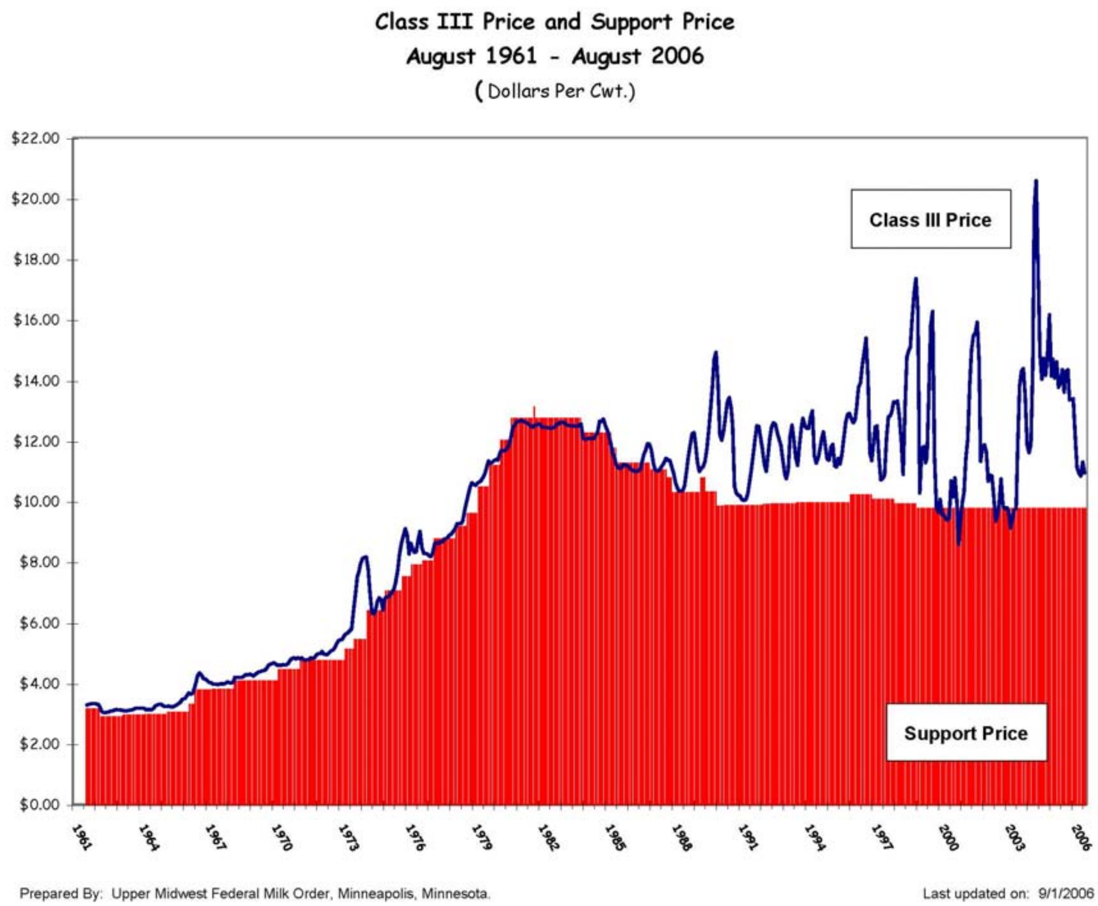
We recognize the potential cost of a higher support price to the federal budget. In order to address this concern, we support legislation to authorize the U.S. Department of Agriculture (USDA) to establish a producer assessment program to fund the increase in the support purchase price. In order have no cost to the federal budget; the $12.50 support price would be funded through an assessment on dairies that expand their operations beyond prevailing market demand. The first 2.4 million pounds of milk produced on dairy farms would be exempt from the assessment in order to foster entry level producers and sustain smaller dairy operations.

Although the $12.50 support price is still below the average cost of production, the higher purchase price would provide a more meaningful level of support to producers. Furthermore, the assessment program would create an effective incentive to ensure dairy production is in line with market demand.

Dairy markets have become captive entities to a few consolidated retailers and marketers in our industry. According to USDA, domestic consumption increases at a rate of over 2 percent per year. Producers increased production from 2002 to 2005 at a rate of less than 1 percent per year. In March 2004, the CCC purchased 3 million pounds of milk equivalent. Since December 2004, CCC purchases have been virtually nonexistent since then with no CCC purchases in 2005 and only a minimal amount thus far in 2006. A lack of competition is also preventing consumers from benefiting from lower producer prices. Many dairy products today contain imported milk protein concentrate (MPC), casein, caseinates and other ingredients that displace high quality and nutritious US produced milk. Due to the lack of competition in the marketplace, we believe producers lack the market power to receive the true value of their milk.

We call upon federal lawmakers to pass the "Milk Regulatory Equity Act," to apply effective tariffs to imports of milk protein concentrate (MPC), casein and caseinates. We call upon federal lawmakers to investigate the alleged anti-competitive trading practices of the CME and take other steps to foster a more competitive marketplace.

We believe the solutions we outlined today will go a long way toward improving the future for dairy producers throughout California. We again thank you for the opportunity to testify here today and look forward to continuing to work with members of the committee on issues affecting farmers and ranchers.


Class III Price and Support Price
August 1961 - August 2006
(Dollars Per Cwt.)
$22.00
$20.00
$18.00
$16.00
$14.00
$12.00
$10.00
$8.00
$6.00
$4.00
$2.00
$0.00
Class III Price
Support Price
1961
1964
1967
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
2003
2006
Prepared By: Upper Midwest Federal Milk Order, Minneapolis, Minnesota.
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